
STATE TAX INCENTIVES FOR ECONOMIC DEVELOPMENT IN WISCONSIN

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TABLE OF CONTENTS

	Page
INTRODUCTION	1
I. CORPORATE INCOME AND FRANCHISE TAX	
A. Description.....	2
B. Credits	2
C. Other Special Tax Treatments	11
II. PROPERTY TAX	
A. Description.....	14
B. Exemptions	14
C. Tax Incremental Finance Districts	15
III. SALES AND USE TAX	
A. Description.....	17
B. Exemptions	17
IV. INDIVIDUAL INCOME TAX	
A. Description.....	18
B. Capital Gains Treatment	18

WISCONSIN BUSINESS TAX INCENTIVES

Wisconsin offers a number of tax incentives for corporations and other businesses to locate or expand their operations within the state. This paper summarizes the major taxes imposed on businesses operating in the state and the tax incentives available to them.

Tax incentives available to businesses include exemptions, credits, and other special corporate tax treatment. In addition, the state has designated certain areas as development zones and local governments have created tax incremental finance (TIF) districts. Businesses locating or expanding operations within development zones are eligible to claim development zone tax credits. Businesses locating operations within a TIF district benefit from infrastructure financed by tax increments. In addition, a technology zones program was recently enacted that provides tax credits for high-technology businesses locating in a technology zone. The paper also discusses Wisconsin's preferential treatment of capital gains and other special tax treatments.

I. CORPORATE INCOME AND FRANCHISE TAX

A. Description

Corporations doing business in Wisconsin are subject to either an income or a franchise tax. Corporate net income is used as the measure or base for the franchise tax and both taxes are imposed at a rate of 7.9%. The 7.9% flat rate has not been changed since 1981, except for a 10% surtax during the 1982 and 1983 tax years.

Computation of net income is federalized, that is, based primarily on the Internal Revenue Code (IRC). The starting point for computing Wisconsin net income is federal gross income, subject to certain modifications. Wisconsin applies federal regulations, rules, and court cases concerning the IRC, when applicable, in determining the proper treatment of an item.

Corporations that conduct business in more than one state must apportion their net income among the states with jurisdiction to tax the income. Until 2006, Wisconsin apportioned income with a formula based on three factors—property, payroll, and sales. In the formula, the sales factor was double-weighted (50%) and the property and payroll factors were single-weighted (25% each). For taxable years beginning in 2006, an apportionment formula based solely on the sales factor will be phased in. For taxable year 2006, the apportionment formula will be composed of a sales factor representing 60% of the fraction, a property factor representing 20% of the fraction, and a payroll factor representing 20% of the fraction. For taxable year 2007, the apportionment formula will be composed of a sales factor representing 80% of the fraction, a property factor representing 10% of the fraction, and a payroll factor representing 10% of the fraction. The single sales factor formula will be fully phased in for taxable years beginning in 2008. Special apportionment formulas will continue to apply to certain industries, such as interstate trucking and financial institutions.

Wisconsin provides for differential tax treatment of business income depending on the form of organization under which a business operates. Business income of S-corporations, partnerships, and limited liability companies that choose to be treated as partnerships is reported and taxed on the individual income tax returns of the owners (shareholders, partners or members) of the business. The Department estimates that there are approximately 107,000 active corporations. Of these corporations, approximately 55,000, or 51.4%, make a subchapter S election to have income flow through to and be claimed on the tax return of the owners of the business. The remaining approximately 52,000 are corporations, referred to as C-corporations, that are designed to pay tax at the entity level. Corporate income and franchise tax collections from all corporations were \$780 million for FY06.

Wisconsin also imposes a recycling surcharge on all non-farm businesses with gross receipts exceeding \$4 million at a rate of 3% on gross tax liability of corporations and 0.2% of net business income for noncorporate business entities. The maximum surcharge is \$9,800 and the minimum is \$25. The surcharge does not apply to entities not required to file an income tax return. Revenues from the recycling surcharge are deposited in the segregated recycling fund and used to fund local government recycling and solid waste management programs and private business efforts to develop recycled products or markets related to these products.

B. Credits

A credit is an amount subtracted directly from the taxpayer's Wisconsin gross tax liability (i.e., the amount determined by applying the Wisconsin tax rate to Wisconsin taxable income) to determine

Wisconsin net tax liability. Generally, business credits are nonrefundable, that is, they are used only to reduce the amount of tax otherwise due. However, unused credits can be carried forward to future tax years to be used to offset tax liabilities in those years. Unused credits may generally be carried forward for fifteen years. There are some credits that are refundable, in that the amount of credit in excess of tax otherwise due is refunded to the taxpayer.

Where available, data are provided on the amount of credit available, used and carried over. Unless otherwise noted, the analysis of the credits is based on the 2004 tax year returns of C-corporations with tax liability of \$570 million. This data does not include credits claimed by S-corporation shareholders and noncorporate business entities, unless otherwise stated.

As used in this paper, "available credit" includes new credit claims for the 2004 tax year plus the amount of any credit that was claimed in prior years but was not used to offset tax liability in those years. "Used credit" is the amount of this available credit actually applied in the 2004 tax year to offset tax liability. "Carryover credit" is the remaining available credit that is not used in the 2004 tax year and that will be available to offset tax liability in future years. Thus, "available credit" less "used credit" equals "carryover credit." A description of the current credits is provided below.

1. *Research Credits.* To encourage corporations to carry on research and development (R&D) activities in the state, three tax credits are available: a credit for R&D noncapital expenditures, a credit for investments in R&D facilities, and an engine research credit.
 - a. *Research Expenditures Credit.* A nonrefundable research expenditure credit for noncapital expenditures related to research activities conducted in Wisconsin is available to corporations. The credit applies only to research expenditures that are undertaken to discover information that is technological in nature and intended to be useful in the development of a new or improved business component. Expenses must be incurred in connection with research conducted in Wisconsin in order to qualify for the credit.

The credit is patterned after the federal research credit and is equal to 5% of the excess of qualified research expenses for the current year over a base period amount. Qualifying expenditures are defined by reference to the rules established under Section 41 of the Internal Revenue Code. The "base period amount" is calculated in the same manner as that for the federal credit, except that the gross receipts used in computing the state credit are from sales attributable to Wisconsin (other than throwback sales) for purposes of apportionment. Qualified research expenses cover in-house expenses for the taxpayer's own research (wages, supplies, and computer use charges) and 65% of amounts paid or incurred for qualified research done by a person other than an employee of the taxpayer. Unused amounts of the credit can be carried forward for up to 15 years.

In 2004, 331 C-corporations had over \$109 million of credit available. The 331 corporations with available research expenditures credits represent only 0.31% of all corporations. Of these corporations, 140 used \$17 million of credits to offset tax liability, leaving \$92 million of credit available for use in future years.

- b. *Research Facilities Credit.* This credit applies to capital investments to construct and equip new research facilities or expand existing facilities located in Wisconsin. The credit is equal to 5% of the amount of qualified investments in tangible, depreciable property that is not replacement property.

The rules relating to the credit are similar to the rules for the research expenditures credit. The credit is nonrefundable, and unused amounts of credit may be carried forward and offset

against tax liability over the next 15 years. To prevent duplication of tax benefits, businesses must increase their net income by the amount of credit claimed in lieu of reducing their deduction for research expenses or reducing their basis in the property.

In 2004, 61 C-corporations had \$13.7 million of available research facilities credits; 16 corporations used \$1.2 million of that available credit to offset tax liability, carrying over \$12.5 million for use in future years.

- c. *Engine Research Credit.* For tax years beginning after December 31, 2007, a credit equal to 10% of qualified research expenses related to designing internal combustion engines and related substitutes such as fuel cells, electric, and hybrid drives will be available. The credit is also available for research related to designing vehicles powered by such engines and for research on improving production processes for such engines and vehicles.
2. *Sales Tax Credit for Fuel and Electricity Used in the Manufacturing Process.* For tax years beginning on or before December 31, 2005, an income and franchise tax credit was available for sales tax paid on fuel and electricity used directly in manufacturing operations. The credit was equal to 100% of the sales tax paid. It was not refundable, but unused amounts could be carried forward for up to 20 years to offset income and franchise tax in future years.

In 2004, more than 2,100 C-corporations had available manufacturers' sales tax credit totaling over \$258 million. Of those corporations, 983 used \$27 million to offset tax in 2004. More than 1,650 S-corporations had \$22.4 million of available credit; most of the amount was passed through to shareholders for use in offsetting their individual income tax liability.

Beginning in 2006, the income and franchise tax credit was replaced with a sales tax exemption. Treatment of unused credits from prior years depend upon the amount of unused credit. Businesses with no more than \$25,000 of carryforward are allowed to claim up to half of that amount in 2006 and 2007. These businesses represent nearly 80% of all businesses with carryforward, but only 4% of the unused credit.

The credit carryforward of businesses with more than \$25,000 of unused credit would be disallowed. However, affected firms may deduct, over two years, the amount that was added back to income when the credits were claimed.

Beginning on January 1, 2008, firms may claim a new nonrefundable credit equal to total unused manufacturers' sales tax credit carryforwards held before the credit was repealed. The unused credit would be amortized equally over 15 years. Companies would be allowed to take the credit beginning in 2008 only if they meet certain investment tests in the year they claim the credit, including:

- retention of 100% of the full-time (at least 35 hours per week) jobs employed by the company as of the effective date of the bill;
- average annual investment since January 1, 2003, equal to 2% of total book value of the company's depreciable assets in Wisconsin-based plants/facilities or \$5 million; and
- other criteria specific to individual industries as determined by the Department of Commerce, in consultation with the Department of Revenue, through administrative rule.

3. *Supplement to the Federal Historic Rehabilitation Credit.* A nonrefundable credit is available to encourage the rehabilitation of historic buildings in Wisconsin. The credit applies to

rehabilitation projects begun after December 31, 1988, and for rehabilitated property placed in service after June 30, 1989.

This supplement to the federal historic rehabilitation credit can be claimed only for projects that are eligible for the federal credit. The state supplemental credit is equal to 5% of qualified rehabilitation expenditures, as defined under Section 48 (g) of the Internal Revenue Code, to substantially rehabilitate certified historic buildings for use in a trade or business. The credit is patterned after the federal credit for commercial rehabilitation of historic buildings. The rehabilitation work must meet historic preservation standards and the expenditures must exceed the taxpayer's adjusted basis in the building. Unused amounts of the credit can be carried forward for up to 15 years. The credit applies only to property located in Wisconsin. Taxpayers must reduce their Wisconsin adjusted basis in the building by the amount of the credit claimed. The reduced basis will result in lower depreciation deductions.

In 2004, approximately \$490,000 of credit was available to five C-corporate taxpayers. Of this amount, \$329,000 was used by four corporations and \$161,000 was carried forward for use in future tax years.

4. *Dairy and Livestock Farm Investment Credit.* A nonrefundable credit is available for 10% of expenses to modernize or expand a dairy or livestock farm. Dairy animals include heifers raised as replacement dairy animals. Livestock include cattle (not including dairy animals), swine, poultry including farm raised pheasants but not including other farm raised game birds or ratites, fish that are raised in aquaculture facilities, sheep, and goats. The aggregate amount of credit that a taxpayer may claim is \$50,000 for expenses to construct, improve, and acquire buildings or facilities and equipment, for dairy animal housing, confinement, feeding, milk production, and waste management. The credit may be claimed for taxable years that begin after December 31, 2003 and before January 1, 2010.

In 2004, \$2.7 million of credit was available to 280 C-corporation taxpayers. Of this amount, \$960,000 was used by 179 corporations and \$1.7 million was carried forward for use in future tax years.

5. *Zone-based credits.* Wisconsin currently has seven zone-based programs to encourage economic development in certain areas: the development zone, development opportunity zone, enterprise development zone, agricultural development zone, airport development zone, enterprise zone jobs credit, and technology zone programs. Under these programs, qualified businesses that locate or expand their operations in certain areas are eligible to claim tax credits. In order to qualify for the credits, a business must first be certified by state and local officials.
 - a. *Development Zones.* The development zone program provides credits to taxpayers that locate or expand a trade or business activity *within* a development zone. Credit is calculated based on the number of full-time jobs created or retained in the state and on amounts spent for environmental remediation in a development zone, development opportunity zone, enterprise zone or agricultural zone, up to the following amounts:
 - \$8,000 for each full-time job created or retained and filled by a member of a target group;
 - \$6,000 for each full-time job created or retained and filled by a person who is not a member of a target group; and
 - 50% of amount spent for environmental remediation.

For purposes of the jobs credit, a member of a target group includes a resident of an empowerment zone or enterprise community designated by the U.S. government, any person employed in unsubsidized or trial jobs under the Wisconsin Works program, and any person qualifying for the Wisconsin Works health plan or child assistance.

In tax year 2004, 21 C-corporations had \$6.3 million of available credit. Eighteen of these corporations used \$2.9 million of credit, leaving \$3.4 million available to offset tax liability in future years. Because of differences in when a corporation is certified by the Department of Commerce and when it files a tax return claiming the credits, reports of the Department of Revenue and the Department of Commerce may differ.

The Department of Commerce is authorized to designate up to 22 economically distressed areas as development zones with credits of \$38.155 million. Based on information from the Department of Commerce, 577 businesses in the zones have been certified to date for approximately \$37.4 million of credits. The zones are in effect for periods of seven to ten years. In addition, businesses operating in development zones have hired 5,127 members of one of twelve statutory target groups.

- b. *Development Opportunity Zones.* Under the development opportunity zone program, corporations, except insurance companies, conducting economic activities in a zone may claim development zone credits allocated to them by the Department of Commerce. Six zones with \$29.4 million in tax credits have been authorized. Only two zones remain open: Kenosha (\$7 million of credits) and Beloit (\$4.7 million of credits). Zones in West Allis (\$3 million of credits), Eau Claire (\$3 million of credits), Milwaukee (4.7 million of credits), and another in Beloit (\$7 million of credits) have expired.

Corporations locating or expanding their operations within the development opportunity zones are also eligible to claim an investment credit that equals 2.5% of the purchase price of depreciable tangible personal property (or 1.75% of the price if the property has been expensed under section 179 of the Internal Revenue Code).

A capital investment credit is available for certain businesses located in the Beloit and Milwaukee zones, and beginning in 2006 airport development zones, equal to 3% of qualified purchases of depreciable tangible personal property and amounts expended to acquire, construct, rehabilitate or remodel qualified real property. The Department of Commerce may authorize credits for a business in these two zones based on the economic activity of a third party.

- c. *Enterprise Development Zones.* Enterprise development zones are areas in which multiple businesses are permitted to operate and receive tax credits. A business planning to conduct economic activity in a specific area of the state can apply to the Department of Commerce to have the area designated as an enterprise development zone. Designation is based on criteria relating to high unemployment, poverty, declining property values, and declining population, and is for a period of seven years. The Department of Commerce is authorized to designate 98 zones; at least 10 zones must be for environmental remediation. Each zone is allocated a maximum of \$3 million credits, so that credits under this program may total as much as \$294 million. Based on information from the Department of Commerce, 61 areas have been designated to date as enterprise development zones and certified for \$146 million of credits. Of the 61 zones designated to date, 32 have expired and 29 are still active. In addition, businesses operating in enterprise development zones have hired 1,749 members of one of twelve statutory target groups.

- d. *Agricultural Development Zone.* The Department of Commerce is authorized to designate one area as an agricultural development zone and may certify up to \$5 million of development zone and development zone capital investment credits to new or expanding agribusinesses in the zone. As designated, the zone has four regions comprising 18 counties. According to information from the Department of Commerce, a total of 23 businesses have been certified for \$3.3 million of credits. The zone has a maximum duration of ten years. In addition, businesses operating in agriculture development zones have hired 86 members of one of twelve statutory target groups.
- e. *Airport Development Zone.* The Department of Commerce was authorized by 2005 Act 487 to designate an area as an airport development zone if the following six criteria are met:
1. the airport development project is desired for the area, as evidenced by a resolution of the governing body of each county, city, village, and town in which territory of the airport development zone will be located;
 2. the airport development project serves a public purpose;
 3. the airport development project will likely retain or increase employment in the state;
 4. the airport development project is not likely to occur or continue without the department's designation of the area as an airport development zone;
 5. the airport development project will likely positively affect the area; and
 6. the airport has at least two runways at the time of the designation, and its primary runway is at least 5,000 feet in length and its secondary runway is at least 3,000 feet in length.

An airport development zone may not be in an area that is a development zone, a development opportunity zone or an enterprise zone. The designation is effective for 84 months. Total income and franchise tax credits for each zone may not exceed \$3 million, and total tax benefits for all zones may not exceed \$9 million. The credit is non-refundable.

- f. *Enterprise Zone Jobs Credit.* For tax years beginning on or after July 1, 2007, a refundable enterprise zone jobs credit against income and franchise taxes is available for certified businesses located in an enterprise zone. The credit has three components: 1) a payroll component based on changes in the claimant's payroll over a base year; 2) a component available only to claimants whose entire property and payroll is in the enterprise zone, which is based on the sum of the claimant's payroll and basis of property; and 3) a component based on the amount a claimant pays for training to upgrade the skills of full-time employees who work in the enterprise zone.

The Department of Commerce is authorized to designate no more than 10 enterprise zones and may not designate an area as an enterprise zone if the area exceeds 50 acres. A designation may be in effect for no more than 12 years. In determining whether to designate an area as an enterprise zone, Commerce must consider indicators of the area's economic need, infrastructure and energy support, the rate of business development, existing resources available to the area, and the effect of designation on other initiatives and programs to promote economic and community development in the area, such as job training and the creation of high-paying jobs.

Commerce may certify for tax benefits a business that:

- begins operations in an enterprise zone;
- relocates to an enterprise zone from outside Wisconsin, if the business offers compensation and benefits to its employees working in the zone for the same type of work that are at least as favorable as those offered to its employees working outside the zone; or
- expands operations in an enterprise zone, if the business will increase its personnel by at least 10% or the business makes a capital investment in property located in the enterprise zone equal to at least 10% of the business' gross revenues in the preceding tax year attributable to business activities in this state.

g. *Technology Zones.* The Department of Commerce is authorized to designate up to eight areas in the state as technology zones with up to \$5 million of non-refundable tax credits for each zone. New or expanding high-technology businesses in a zone may be certified by Commerce for tax credits that may be claimed for up to three years, except that a business that experiences growth may claim the credit for up to five years. The amount of the credit is based on the following expenditures of the business during the tax year:

- the amount of real and personal property taxes;
- 10% of certain capital investments made by the business in the zone; and
- 15% of the amount spent on the first 12 months of wages for each job created in a zone after certification.

Certification is based on the number of jobs anticipated to be created, the amount of capital investment likely to be made, the economic viability of the business, and its potential to attract related enterprises. Each zone has a maximum duration of ten years. All eight zones have been designated and include 54 counties.

In 2004, 15 C-corporations had \$806,000 of available credit. Ten corporations used \$332,000 and the remaining credit was carried forward to future tax years. According to information from the Department of Commerce, 73 corporate and noncorporate entities have been certified for \$15.9 million of credit.

6. *Venture and Investment Capital Credits.* Wisconsin has two tax credits available to corporations which are intended to encourage venture and investment capital in the state, the early stage seed investment credit and the certified capital company (CAPCO) credit.

a. *Early Stage Seed Investment Credit.* Effective for taxable years beginning after 2004, a non-refundable early stage seed investment credit is available for investments in qualified new business ventures that are certified by the Department of Commerce. To be eligible for the credit, a qualified new business venture must meet certain requirements, including that it have its headquarters in the state, have less than 100 employees, at least 51% of whom are employed in the state, and have been in business for not more than seven consecutive years. A qualified new business venture must also be engaged in certain industries: manufacturing, agriculture, processing or assembling products, conducting research and development or developing new products or business processes. The early stage seed investment credit is available for businesses and individuals for 25% of certain investments paid to a fund

manager that are invested in qualified businesses. The total amount of credits that may be claimed is \$3.5 million per taxable year and \$35 million for all taxable years. The total amount of credits that may be claimed in a taxable year is \$3.5 million.

- b. *Certified Capital Company Credit.* Under the Certified Capital Company (CAPCO) Credit program, insurers that pay a license fee to the Office of the Commissioner of Insurance based on gross premiums, rather than an income or franchise tax to the Department of Revenue, may claim a credit against their license fees for investments in CAPCOs. Insurers eligible for the credit are life insurers, out-of-state accident and health insurers, mortgage guarantee insurers, out-of-state fire and ocean marine insurers, and out-of-state companies that sell other kinds of property and casualty insurance. The Department of Commerce may certify up to \$50 million of investments under this program. Insurers must make their investments in a CAPCO in a lump sum and generally may claim 10% of that amount per year as a credit against its license fees for ten years. CAPCOs must invest at least 30% of the \$50 million within three years and 50% within five years in high-technology businesses. Thirty-three insurance companies have invested \$50 million in three venture capital companies certified as CAPCOs by the Department of Commerce. In the period from 2000 to 2005, the CAPCOs made 19 qualified investments totaling approximately \$26 million.

7. Other Credits

- a. *Film Production Credits.* For tax years beginning after December 31, 2007, several tax credits will be available for expenses related to film production activities for productions accredited by the Department of Commerce. The credits include:
 - A film production services income and franchise tax credit. The credit is equal to 25% of salary or wages paid for services rendered in Wisconsin to produce an accredited production and paid to Wisconsin employees. The credit for salary or wages paid must not exceed an amount equal to the first \$25,000 of salary or wages paid to each of the claimant's employees, not including the salary or wages paid to the claimant's two highest paid employees. The credit is also equal to 25% of production expenditures paid by the claimant in the taxable year to produce an accredited production.
 - A sales and use tax credit for taxes that the claimant paid in the taxable year on the purchase of tangible personal property and taxable services that are used directly in an accredited production.
 - A film production company investment credit. A claimant may claim a credit against income and franchise taxes, up to the amount of the taxes, for the first three taxable years that the claimant is doing business in Wisconsin as a film production company, an amount equal to 15% of the purchase price of depreciable, tangible personal property and the amount expended to acquire, construct, rehabilitate, remodel or repair real property.

The portion of the credit applicable to production expenditures is refundable. The remainder of the credits may be carried forward for 15 years.

- b. *Broadband Internet Equipment Exemption and Credit.* A sales and use tax exemption and a non-refundable income tax credit were created by 2005 Act 479 that apply to the purchase of "Internet equipment used in the broadband market." This equipment is defined to be equipment that is capable of transmitting data packets or Internet signals at speeds of at least 200 kilobytes per second in either direction. For a purchaser of Internet equipment used in the broadband market to receive the sales and use tax exemption, the purchaser must certify

to the Department of Commerce, that the purchaser will, by July 1, 2009, make an investment that is reasonably calculated to increase broadband Internet availability in Wisconsin and the Department of Commerce must certify the purchaser as eligible for the exemption. The purchases cannot take place before July 1, 2007, which is when the sales and use tax exemption takes effect.

For a purchaser of Internet equipment used in the broadband market to receive the income tax credit, the purchaser must have claimed the sales and use tax exemption described above and be certified by the Department of Commerce as eligible for the tax credit. The total amount of sales and use tax exemptions and income tax credits may not exceed \$7.5 million.

- c. *Farmland Tax Relief Credit.* A farmland tax relief credit equal to a percentage, established by the Department of Revenue, of property taxes on farmland, exclusive of improvements, is allowed for owners of farmland. This credit is refundable. The credit percentage is set so that the amount expended for the credit for all claimants, individual and corporate, is \$15 million, adjusted for underspending or excess spending in the prior fiscal year.
- d. *Farmland Preservation Credit.* Corporations are eligible for Farmland Preservation Credits and must meet basically the same requirements as individual taxpayers. Income for corporations is defined as the sum of net corporate income, any business loss carryforward allowed under section 71.26 (4), Wis. Stats., and the household income of each corporate shareholder including the income of spouse, dependents, and other members of the household. Corporations must include in their household income farm depreciation in excess of \$25,000, all nonfarm depreciation, and nonfarm business losses. The credit is refundable.
- e. *Community Development Finance Credit.* A credit is allowed for capital investments in the Wisconsin Community Development Finance Company. Corporations that make contributions to the Wisconsin Housing and Economic Development Authority (WHEDA) and, in the same year, purchase common stock in the Community Development Finance Company may claim the credit, which is equal to 75% of the cost of common stock or a partnership interest purchased in the Community Development Finance Company. The base for computing the credit is limited to the value of the claimant's contribution to WHEDA.
- f. *Credit for Insurance Security Fund Assessments.* Chapter 646, Wisconsin Statutes, provides a credit against state taxes, including the corporate income and franchise tax, for certain assessments levied on insurance companies by the Wisconsin Insurance Security Fund. The fund is designed to protect policyholders in cases where their insurance company has failed and is in the process of liquidation. Where the available assets and reserves of failed insurers are inadequate to meet claims, the fund may assess insurance companies doing business in the state, with some exceptions (e.g., fraternal benefit societies). Such assessments are eligible for a 100% tax credit if they cannot be recovered through higher premiums. This can occur where premiums are fixed on a particular line of business. The tax credit is nonrefundable and must be claimed in equal installments over a five-year period, beginning with the year following the one in which the assessment is made (20% per year for 5 years after the assessment is paid).
- h. *Health Insurance Risk-Sharing Plan Assessments Credit.* An income and franchise tax credit and a license fee credit are available for insurers that pay assessments for the Health Insurance Risk-Sharing Plan (HIRSP). HIRSP offers health insurance coverage to individuals with adverse medical histories and to others who cannot obtain affordable health insurance coverage from the private sector. HIRSP is funded by premiums paid by participants, assessments paid by insurance companies, and a pro rata reduction in billed

charges of health care providers. The amount of the credit for all insurers cannot exceed \$5,000,000 per year. The credits apply to taxable years beginning after December 31, 2005, but the credits for the 2006 and 2007 tax years may not be claimed until taxable years beginning after December 31, 2007.

C. Other Special Tax Treatments

Wisconsin offers additional tax incentives in the form of deductions, exemptions, apportionment provisions, and organizational form of entity.

1. *Deduction for Corporate Dividends Received.* A deduction is allowed for 100% of dividends received from subsidiaries in which the parent company owns at least 70% of the voting stock. The rationale for the deduction is that corporations are required to treat their investment income, including dividends, as business income subject to the multistate apportionment formula. In the case of dividends received from unitary subsidiaries, the transactions do not constitute the realization of income but merely the transfer of funds among branches of a unitary business entity. The deduction, it is argued, provides the same treatment as that for similar transfers of funds among unincorporated divisions, which are not taxed.

The dividends deduction provides substantial benefits for corporations headquartered in Wisconsin that have large investments in non-Wisconsin subsidiaries. Often these subsidiaries generate earnings that would normally be treated as apportionable business income under a unitary approach to taxing corporations. However, the absence of combined reporting in Wisconsin along with the deduction for intercorporate dividends means that all of this income is exempt from Wisconsin taxation. Because corporations are not required to report the dividends received from subsidiaries, the value of this deduction is not known.

2. *Apportionment Formula.* Wisconsin requires multijurisdictional corporations to compute the amount of their income that is taxable in this state through the use of a three-factor apportionment formula. The factors in the formula are based on the relationship of a company's property, payroll, and sales in Wisconsin to the total property, payroll and sales in all jurisdictions. Each factor represents a ratio, which is assigned a weight and then combined to yield a single income apportionment percentage. Approximately 17,000 corporations apportion income.
 - a. *Double-Weighted Sales Factor.* Until tax year 2006, the sales factor in the apportionment formula was assigned a double weight. Giving greater weight to the sales factor benefits firms with substantial property and payroll in the state and relatively larger sales outside the state.
 - b. *Single Sales Factor Beginning in 2006.* Beginning in 2006, an apportionment formula based solely on the sales factor will be phased in for most corporations. Certain industries will be subject to special apportionment formulas. The weight of the sales factor will increase to 60% for taxable years beginning in 2006, 80% for taxable years beginning in 2007, and 100% for taxable years beginning in 2008.

A multi-state company based in Wisconsin (and therefore having a larger share of its total property and payroll in the state) with relatively greater sales outside Wisconsin benefits from a single sales factor formula. For example, a company with 80% of its property and 60% of its payroll attributed to Wisconsin and in-state sales of 20% would apportion 45% of its income to Wisconsin under the double-weighted sales factor formula $((80\% + 60\% + 20\% + 20\%) / 4 = 45\%)$. If income were apportioned with a single sales factor formula, the company would apportion 20% of its income to Wisconsin.

At the other extreme, a non-Wisconsin corporation with 1% of its property and 0.5% of its payroll in Wisconsin and Wisconsin sales of 2% would have a Wisconsin apportionment factor of 1.38% under the present double-weighted sales formula. This company would apportion 2% of its income to the state under the single sales factor formula. While the difference between 2% and 1.38% may not appear to be overly significant, when applied to the apportionable income of a large multi-state or multinational corporation, the difference in Wisconsin corporate tax liability can be substantial.

- c. *"Throwback" Sales.* In calculating the sales factor under the multi-state apportionment formula, taxpayers are required to treat certain "throwback" sales as being the equivalent of Wisconsin sales. Throwback sales are shipments to the federal government or to customers located in states where the seller is not subject to tax due to the nexus standards defined by federal law (P.L. 86-272) and further clarified by the Wisconsin Administrative Code. Unlike other Wisconsin sales, however, throwback sales are included in the sales factor at half their amount.

Under nexus standards, a corporation must have some type of operations in a state in the form of property or employees before its income can be taxed by that state. A corporation cannot be taxed by a state in which it does not have nexus. The purpose of the throwback rule is to ensure that 100% of a multi-jurisdictional corporation's income is apportioned to states with jurisdiction to tax it (it does not matter if the state actually imposes a corporate income tax). In the absence of a throwback rule, sales to destinations where the seller does not have nexus would not be included in the numerator of the sales factor of any state. This would result in a company paying tax on less than its entire income.

3. *Exemption for Activities of Out-Of-State Publishers and Certain Other Foreign Corporations.* Certain foreign corporations are exempt from the state nexus guidelines and, therefore, are not required to file a Wisconsin tax return. In particular, out-of-state publishing companies that contract with Wisconsin printing firms for the printing, storage and distribution of books, magazines, and other publications are exempt from income and franchise tax. As a result, foreign publishers, often with no payroll, plant or equipment in Wisconsin, are not liable for Wisconsin tax simply because they purchase raw materials and store inventory on the premises of in-state printers. This exemption removes a disincentive for the publishers to do business with in-state printers.

In addition, the temporary storage of inventory on the premises of Wisconsin firms when the intent is to distribute all of the goods outside the state does not create nexus for the out-of state firms.

4. *Pass-Through Entities.* Wisconsin law permits the formation of Subchapter S corporations and limited liability companies. Both of these entities combine the benefits of limited liability offered to corporations with pass-through of income to the individual owners. Thus, these entities generally pay no tax at the entity level. Instead, income is passed through to the individual shareholders or members, who pay tax on the income at the lower individual income tax rates. (The individual income tax rates range from 4.6% to 6.75%, compared to the 7.9% corporate income tax rate.) This flow-through aspect of income also avoids the double taxation of dividends that occurs when profits are first taxed at the corporate level and then again at the individual level, when profits are distributed as dividends to individual shareholders.
 - a. *Subchapter S Corporations.* Wisconsin has federalized its treatment of Subchapter S corporations. Subchapter S, or "tax-option" corporations, elect to have most of their income

exempted from the corporate income tax. The net profit or loss of these companies is instead attributed to stockholders on a prorated basis and taxed under the individual income tax. Typically, "tax-option" corporations are small businesses with fairly simple capital structures. The Internal Revenue Code restricts the number of shareholders to a maximum of 75. It also imposes a number of other limitations, such as the amount of passive investment income that can be earned and the types of stock that can be issued.

Tax liability is determined as of the end of each stockholder's tax year and must be paid regardless of whether or not the corporate income has been distributed. An important benefit of the structure is that capital gains realized by the corporation qualify for the state 60% net capital gain deduction when the gains are passed through to the shareholders.

- b. *Limited Liability Companies (LLCs)*. Limited liability companies may elect to be taxed as partnerships wherein income of the company flows through to the owners (called members) and is taxed at lower individual income tax rates rather than at the higher corporate rate. LLCs allow for greater flexibility than S-corporations in the way they can be structured. For example, while S-corporations allow only individuals to be owners, LLC members can include corporations, partnerships, foreign entities, trusts, and charitable organizations as well as individuals. An LLC can have an unlimited number of members as owners, and profits and losses can be more freely allocated among the members.

II. PROPERTY TAX

A. Description

All real and tangible personal property is subject to taxation unless expressly exempt. Except for farmland, agricultural forest and undeveloped land, real property is assessed at full market value, i.e., the full value ordinarily obtained at private sale, and personal property is assessed at true cash value. Classes of real property include residential, commercial, manufacturing, agricultural, agricultural forest, undeveloped, productive forest land, and other (defined as farm buildings and improvements to land). Intangible property is not subject to the property tax.

Except for manufacturing, telecommunication, and utility properties, valuation is made by the municipal assessor. Property is assessed on the value as of January 1. Manufacturing, telephone, and utility properties are assessed by the Department of Revenue. Manufacturers annually submit, on or before March 1, self-reporting forms of the original installed costs of all property owned that is still in operation. The Department of Revenue conducts field appraisals of each parcel once every five years.

Property tax incentives include specific exemptions and special tax districts.

B. Exemptions

1. *Machinery and Equipment Used in Manufacturing.* Machinery and equipment used in manufacturing is exempt from property taxes – the exemption greatly reduces the property tax burden on manufacturers. There are approximately 11,000 manufacturers in the state. In 2005, \$1.3 billion of manufacturing machinery and equipment was taxable. Assuming that 10% of all manufacturing machinery and equipment is taxable, approximately \$11.7 billion of machinery and equipment is currently exempt from tax. Based on this assumption, the 2005 exemption resulted in an estimated tax shift of \$242.8 million from owners of manufacturing machinery and equipment to other property owners.
2. *Merchants' and Manufacturers' Inventories.* Inventories of manufacturers and merchants are fully exempt from personal property taxes. A tax on inventories is viewed as inequitable because businesses differ in their annual inventory cycle, making a fixed date of assessment a poor measure of average inventory levels. In addition, taxing inventories penalizes businesses for storing products in Wisconsin.
3. *Waste Treatment Facilities.* Certain facilities used to treat wastes are exempt from general property taxation. A waste treatment facility is property (land, improvements, and machinery) used for the treatment of industrial waste materials, including particulates, gas, solids, liquids, and other superfluous products. Qualifying facilities must remove, alter or store waste materials. The exemption is available to utilities, manufacturers, and commercial businesses. The Department estimates that approximately \$2.5 billion of manufacturing and commercial waste treatment property is exempted. An estimate of the amount of utility waste treatment property that is exempted is not available.
4. *Computer Equipment.* Wisconsin provides property tax exemptions for certain computer equipment. Exempt from tax are: mainframe computers, minicomputers, personal computers, networked personal computers, servers, terminals, monitors, disk drives, electronic peripheral equipment, tape drives, printers, basic operational programs, systems software, prewritten software, fax machines and cash registers. The exemption does not apply to copiers, custom software, equipment embedded with computerized components or telephone systems. Special payments are made to affected local municipalities to compensate for the lost tax base. In 2005,

approximately \$3.16 billion in computer equipment was exempted, and computer aid payments totaled \$67.7 million.

C. Tax Incremental Finance Districts

Wisconsin allows the use of tax incremental finance (TIF) districts and environmental remediation TIFs as development tools for cities, villages and, for limited projects, towns and counties. The purpose of TIF is to encourage economic development that would not occur without some assistance. A municipality may form a tax incremental district, or TID, for purposes specified by statute. These purposes, as well as other statutory requirements and restrictions, vary by type of municipality and are discussed below.

A review board made up of representatives from the overlying taxing jurisdictions and a public member must approve the creation of the district and the district's project plan, and must assert that the development would not occur without the TIF district. This board may request DOR review of objective facts regarding a proposed TID – the description of boundaries, the finding that the TID satisfies territorial limits, and the finding that the proposed TID is blighted, in need of rehabilitation or suited for industrial or mixed use.

When a TIF district is created, the current value in the district is set as its "base value." Improvements and development that occur after the district's creation lead to increases in its value over the base value, referred to as "increment value." The property taxes levied by all taxing jurisdictions (i.e., the municipality, county, school district, and technical college) on the increase in the district's value are used to pay the public improvements needed for the development to occur.

In this way, the cost of providing the infrastructure for the district is not incurred solely by the municipality, but is shared among all taxing jurisdictions. Typical public improvements in a district include land acquisition, sewer and storm water construction, and street improvements. Property owners in the district pay the same amount of property taxes as they would outside a TIF district; however, the taxes paid on the value increases go directly to paying for the public improvements made within the district. The tax on the base value continues to go to the taxing jurisdictions that levy the tax. After a TIF district terminates, the taxes paid by the property owners within the district, both on the base value and on the increment value, are shared by all taxing jurisdictions.

1. *TIF for Cities and Villages.* Cities and villages that create a TID must declare the type of district created: "blighted," "rehabilitation or conservation," "industrial" or "mixed-use." The declaration is based on the type of real property that makes up at least 50% of the area in the district or which of the four types is predominant in the district. Each type of TID must meet specific requirements for its designation and adhere to defined project expenditure and maximum life periods.

A city or village may create a TID as long as the equalized value of the proposed TID, plus the increments of all existing TIDs in the municipality, do not exceed 12% of a municipality's total value. The 12% test does not apply if, simultaneously, a new TID is created and territory of equal or greater value is subtracted from an existing TID. In addition, annexed land may not be included in a TID until three years after its annexation, unless there is a border agreement or tax payment to the town by the annexing municipality. A municipality may amend a TID project plan up to four times after its creation.

Counties with no cities or villages may create a TID if the town board in which the proposed TID is located adopts a resolution approving the creation of the district. A town may use city powers to create a TID if the town has entered into a cooperative plan with a city or village for

annexation of the town or part of a town in a future. The annexing city or village must approve the creation of the town TID.

From the inception of TIF law in 1975 through 2005, 1,427 districts have been created and 919 are still active. Of the 516 districts that terminated or dissolved, the average life of a district was 12.6 years. Upon termination, these 516 districts resulted in an increase of \$7.8 billion in taxable value.

2. *Town TIF.* In addition to the town TIDs allowed through cooperative plans, as noted above, beginning on October 1, 2004, towns can create TIDs for limited projects that fall within the following North American Classification System (NAICS) codes:

- Agricultural: crop production (111), agricultural production (112), support activities for agriculture (1151) or animal production (1152), and refrigerated farm product warehousing and storage (493120).
- Forestry: forestry and logging (113) and support activities for forestry (1153).
- Manufacturing: animal slaughtering (3116), wood product manufacturing (321), paper manufacturing (322), and ethyl alcohol manufacturing (325193).
- Tourism: recreational and vacation camps (721214), recreational vehicle parks and campgrounds (721211), racetracks (711212), dairy product stores included in 445299, and public golf courses included in 71391. (Classification 445299 includes more than dairy product stores and 71391 includes more than public golf courses.)

Limited residential development, including sleeping quarters for employees, is permitted in town TIDs, though hotels and general residential development are specifically prohibited. Also, retail development is permitted only for products that are produced as a result of an agricultural or forestry project. Town TIDs also are subject to many of the provisions that apply for TIDs in cities and villages.

To date, one town TID has been created.

3. *Environmental Remediation TIF.* Since 1997, cities, villages, towns, and counties have the authority to create environmental remediation tax incremental financing (ER TIF) districts to recover the costs of remediation of environmental pollution. The funding mechanism is the same as other TIF districts; however, there are several differences between the two financing tools.

Project expenditures for ER TIF districts are limited to costs associated with environmental remediation, such as professional services associated with the investigation, containment, removal, and monitoring of contaminants. Expenditures in an ER TIF district may be incurred prior to the creation of the district.

To date, 14 municipalities have created ER TIF districts.

III. SALES AND USE TAX

A. Description

Wisconsin imposes a 5% tax on the sale or use of tangible personal property that is not specifically exempted from the tax and on selected services that are explicitly listed as subject to tax. Taxable services include hotel or other temporary lodging, admissions, certain telecommunications and telephone answering services, laundry and dry cleaning, photographic services, parking, repair and other services to tangible personal property, certain printing and production services, cable television services, and landscaping services.

Counties may impose a 0.5% local sales and use tax on the same tax base as the state sales tax. As of July 1, 2006, 59 of the state's 72 counties impose the additional tax. A 0.5% professional football stadium district sales and use tax is imposed only in Brown County. Proceeds of this tax are used to finance renovation of Lambeau Field in Green Bay. A 0.1% professional baseball park district sales and use tax is imposed in five counties (Milwaukee, Ozaukee, Racine, Washington, and Waukesha). Proceeds of this tax are used to finance a new baseball park for the Milwaukee Brewers.

B. Exemptions

The following exemptions from the sales and use tax apply to a wide number of industries. In addition, Wisconsin provides exemptions targeted at specific industries, including meat packing, printing, newspapers, logging, and motion pictures.

1. *Manufacturing Machinery and Equipment.* Wisconsin allows a comprehensive sales and use tax exemption for purchases of machinery and equipment used directly and exclusively in a manufacturing process. Manufacturing is defined as the production of a new item of tangible personal property using machinery. The new article must be of a different form or have a different use or name than the material from which it was created. Machinery and equipment used in activities such as the storage or delivery of finished products or research and development are not exempt. In FY05, the sales and use tax exemption for manufacturing machinery and equipment reduced sales and use taxes by an estimated \$159 million for the approximately 10,000 manufacturers in the state.
2. *Manufacturers' Materials.* Wisconsin exempts from sales and use tax tangible personal property that becomes an ingredient or component part of an item of tangible personal property. Wisconsin also exempts sales of tangible personal property that is consumed or loses its identity in the process of manufacturing tangible personal property.
3. *Fuel and Electricity Used in Manufacturing.* Beginning January 1, 2006, fuel and electricity used in manufacturing is exempt from sales tax. This exemption replaced the income and franchise tax credit for sales and use taxes paid for fuel and electricity used in manufacturing. This exemption is estimated to reduce sales and use taxes by \$31 million annually.
4. *Pollution Abatement, Waste Treatment, and Recycling Equipment.* Wisconsin exempts from sales and use tax pollution abatement equipment and waste treatment facilities. Also exempted are replacement parts, chemicals and supplies used for pollution abatement or waste treatment. The pollution abatement equipment and waste treatment exemption reduced sales and use taxes by an estimated \$16 million in FY05.

IV. INDIVIDUAL INCOME TAX

A. Description

Wisconsin imposes an individual income tax on a tax base that, to a large extent, conforms to the federal personal income tax base. There are, however, several important exceptions. Although Wisconsin law is based largely on federal law, the Legislature annually determines whether federal law changes should apply for Wisconsin tax purposes.

The starting point for determining Wisconsin taxable income is federal adjusted gross income (FAGI), subject to certain modifications and adjustments to account for differences in Wisconsin and federal law. From that base, the standard deduction and personal exemptions are subtracted to arrive at taxable income. Tax rates are then applied to determine gross tax liability, from which certain credits are then deducted.

The tax rates are shown in the following table. For all tax years beginning after 2001, all personal income tax brackets are indexed each year based on the consumer price index.

TABLE 1
TAX RATES AND BRACKETS, 2006

Single	Married, Joint	Married, Separate	Marginal Tax Rates
\$0 - \$9,160	\$0 - \$12,210	\$0 - \$6,110	4.60%
\$9,161 - \$18,320	\$12,211 - \$24,430	\$6,111 - \$12,210	6.15
\$18,321 - \$132,230	\$24,431 - \$176,300	\$12,211 - \$88,150	6.50
\$132,231 +	\$176,301 +	\$88,151 +	6.75

If the personal income tax imposed for Wisconsin tax purposes, not considering certain credits, is less than the Wisconsin alternative minimum tax, the Wisconsin alternative minimum tax is imposed.

Wisconsin offers tax benefits to individual taxpayers to encourage investment in the state that include special tax treatments for capital gains.

B. Capital Gains Treatments

1. *Exclusion for Long-Term Capital Gains.* Wisconsin allows individual taxpayers to exclude 60% of the net capital gain on assets held more than one year. This exclusion is intended to encourage capital investment and risk-taking by investors. The special tax treatment is also designed to partially offset the adverse effect of inflation on gains realized over a long period of time. The amount of the 60% exclusion is also not included in the tax base for the state alternative minimum tax. The capital gains exclusion reduced individual income taxes on investors by \$156 million in FY04.
2. *Special Capital Gains Treatment for Wisconsin Small Businesses.* An exclusion is provided for 100% of the capital gains from the sale of stock in eligible Wisconsin small businesses that is held for five or more years. This exemption first applies to the gain on the sale of stock acquired on or after January 1, 1986. Qualified small business stock is defined as shares issued by a corporation that:
 - Has at least 50% of its payroll and property in Wisconsin;

- Has no more than 500 employees;
- Derives no more than 25% of its gross receipts from rents, interest, dividends, and sales of intangible investment assets combined;
- Has not previously issued stock that is traded on any of the major stock exchanges;
- Has not liquidated or reorganized for purposes of qualifying for this exemption.

There are a limited number of investments qualifying for the exclusion, and the tax benefit it provides is believed to be minimal.

1. *Capital Gains Exclusion for Intergenerational Transfers of Farming and Business Assets.*

Wisconsin excludes from income all capital gains from intergenerational transfers of farming and business assets that are held more than one year and are sold or otherwise disposed of to persons related to the seller within the third degree of kinship. The exclusion applies to a limited number of transfers each year.